



Douglas County Internal Audit

March 21, 2014

Douglas County Board of Commissioners
1819 Farnam Street, Suite LC2
Omaha, NE 68183

Attention: Mary Ann Borgeson, Mike Boyle, Clare Duda, Marc Kraft, PJ Morgan,
Chris Rodgers and Pam Tusa

Eric Carlson, Purchasing Agent
1819 Farnam Street
Omaha, NE 68183

Jim Tourville, Administrator
DeDe Will, Director of Finance
Douglas County Health Center
4102 Woolworth Avenue
Omaha, NE 68105

Dear Commissioners, Mr. Tourville, Mr. Carlson, and Ms. Will:

I have completed an audit of inventory management for the County. The purpose of the audit was to assess the adequacy and effectiveness of the controls currently in place over managing inventories at the County Warehouse and Health Center. The audit revealed that there are some issues related to inventory access and security at the Health Center and overstocking of numerous inventory items at the warehouse. These issues and opportunities to improve controls were identified and appear below.

Background

Douglas County purchases approximately \$3.1 million of pharmaceuticals and \$2.1 million of supplies. At June 30, 2013 the inventories for the Pharmacy, Health Center Central Supply and the Warehouse were approximately \$128 thousand, \$44,000 and \$497 thousand respectively. The Central Supply purchases include items such as gauze, tape, syringes, etc. Examples of Warehouse items purchased include paper, perishable and non-perishable food, personal hygiene items and clothing. The Pharmacy has made large strides in reducing its inventories. It decreased almost \$100 thousand from the previous year. One of the reasons the Pharmacy can keep its inventories so low is that they are normally able to receive the products the day after ordering. The Warehouse and Central Supply inventories have remained fairly consistent over the years. There are generally longer lead times for the Warehouse products and some items are

special ordered. Both the Warehouse and Central Supply use an order point system to replenish supplies; orders quantities are preset to return to an established level. The Pharmacy uses visual cues (i.e., an empty container) to order products as they run out.

Objective

Specific objectives to be achieved by the audit included determining if management had policies and procedures in place to ensure that:

- Inventory was adequately safeguarded.
- Inventory records were accurate.
- Inventory was stocked and ordered at appropriate levels and times.
- There were procedures in place to identify obsolete and slow moving inventory.
- Management had procedures to dispose of obsolete inventory.
- Inventory costs were accurately reflected in the financial statements.

Scope

The scope of the audit included an assessment of the policies and procedures in place at the Warehouse and Health Center as of December, 2013. Tests of individual financial transactions and internal and external orders included all periods needed to satisfy the particular tests (e.g., test of purchases went back several months to establish accurate costs and order quantities). There were physical inventory tests to establish the accuracy of on-hand quantities. Access to inventories was also tested to determine if there was any security or segregation of duties issues.

Methodology

The information used by Internal Audit was obtained through analysis of written policies and procedures, interviews, physical observations and data and reports obtained through various systems as of the date identified in the scope. Along with an assessment of the policies and procedures as understood, tests were performed to verify the accuracy of system-produced data and adherence to departmental policies. The tests included but were not limited to the following steps below:

- System access listings were reviewed to determine if inventory access was justified.
- Physical counts were compared to reporting for on-hand quantities.
- Orders were reviewed to determine if quantities were ordered in appropriate quantities and intervals.
- Obsolete inventory was properly identified and properly disposed.
- Inventory was properly valued.

The issues identified appear in the Findings section below:

Findings

Usage and Order Quantities

Criteria: Inventory should be ordered to ensure adequate quantities are on-hand to meet demand and to keep inventory investment to a minimum. Reporting mechanisms should be in place to help management achieve optimal on-hand and order quantities based upon actual usage patterns.

Condition: There were a number of issues related to policies for on-hand and ordering quantities as well as adhering to the established policies for the Warehouse and Central Supply. The Oracle minimum level for on-hand warehouse inventory is set at one month of usage and three months of usage is suggested for vendor orders when levels fall below the minimum on-hand quantity. Dietary product is set at one month minimum for on-hand quantity and two months of usage for suggested orders. Twelve non-food and eight food items were tested to see if order quantities met the policies outlined above. Seven of the last orders for the twelve non-food items selected in the testing sample exceeded the stated policy of ordering for 3 months usage. The average order quantity for all products was 4.6 months. Six of the last orders of the 8 food items tested exceeded the stated policy of ordering for 2 months of usage. The average order quantity for all dietary products was 3 months of usage.

Central Supply inventory is recorded in an Access database and management sets minimum quantities for items in the database. Reports are periodically produced showing the items below the minimum and the order quantities needed to return to the minimum levels. The minimum quantities are not necessarily based upon established usage quantities. Usage reports generated from the IMS system indicated that orders were being placed for items with no usage or in excessive quantities based upon an average usage observed over the past two fiscal years. Seven of fifteen items tested had orders placed within the period under review. Reporting indicated that there was no usage for three of the items ordered. Additionally, one item was ordered for eight months of normal usage and another for six months.

Effect: Excessive quantities of inventory were ordered. Additionally, obsolete or very slow-moving items may not have been identified. Investment in inventory is higher than necessary.

Cause: Minimum and maximum inventory levels were not always adjusted to reflect current usage levels. For the Warehouse, Oracle does not provide adequate reporting to support effective inventory analysis. Specific information that Oracle cannot provide or the users have been unable to obtain includes the age of inventory items, zero usage items, and the inclusion of all inventory items in usage reports over specific periods. Much manual effort is required to provide appropriate analysis. Additionally, the policies used to control on-hand and ordering quantities do not reflect current materials management practices that discourage high inventory levels. Most vendors now have abilities to provide products at highly reduced lead times. The management of the pharmaceutical products is an example of successful efforts to reduce inventory levels.

For Central Supply, other testing performed indicated that there may be other issues besides not changing the ordering levels within the inventory database. Large discrepancies in on-hand testing indicate that usage is not being accurately recorded. See the Physical Count finding below along with applicable recommendations.

Recommendation: Request the development of Oracle-generated data to reduce the need to manually analyze inventory. This would include the information identified in the Cause section

above. Increase efforts to reduce inventory levels by lowering minimum on-hand and order quantities. Reducing the investment in Warehouse inventory by 25% would result in a one-time savings of \$125,000. This in turn could lead to further operational savings by reducing the cost of obsolescence and the amount of space needed to store product. One of the freezers currently in use to store perishables could possibly be shut down. There would, however, be an increase in the costs related to an increase in product orders.

Management Response: Purchasing recognizes that some inventory levels could be reduced given better data tools and some level of automation. We will work with DOT.Comm to determine what capabilities are available with the current version of Oracle. Meanwhile, our primary Inventory buyer Nicole Carlberg will work with Norma Drake, Head of Dietary at Douglas County Health Center (DCHC), to utilize their production system data to maximize dietary product order quantities and on-hand quantities to more closely match the DCHC dietary production requirements. Purchasing recognizes that we may see an increase in costs with the increase in order frequency short-term. Purchasing will also look at switching to a primary supplier model (as opposed to bidding every 3 months to multiple suppliers) with the goal of leveraging improved lead-times and lower costs in the long-term.

DCHC will continue to review ways to improve ordering and monitoring usage (other than by reviewing expenses per budget line). The Electronic Health Record proposals are being evaluated with Central Supply and Pharmacy inventory management as criteria for consideration.

Security and Access

Criteria: Management should adequately safeguard its assets and provide access to only those persons needing it to perform their job functions and to provide for appropriate segregation of duties in the management of its inventories.

Condition: Access to inventories and the systems that track them was reviewed. Access to the Millenium system that is used to provide access throughout the Health Center was also reviewed. See below for the issues that were noted:

- There is no reporting generated by the Millenium system that is used to verify that the data entered into the system was entered accurately.
- There was no periodic analysis of Millenium records to assess all access within the Health Center.
- There is no perpetual system to track pharmaceutical inventory.
- There are no security cameras placed in the pharmacy that could help serve as a mitigating control for a lack of a pharmaceutical inventory system.
- The Clerks who physically control the Central Supply Inventory also are responsible for adjusting the Central Supply inventory records.
- The Oracle username and password of the Warehouse Supervisor is being shared with one other employee.

Effect: The effects of the above conditions are reflected as follows:

- Not counting Security Officers, thirty-one persons have access to Central Supply. Of these, two were former employees and one was an administrative employee that did not

need access to Central Supply. Determining accountability for inventory shortages is difficult at best with so many persons having access to inventory.

- One of the former employees with Central Supply access was a Security Officer who had active access to all functions in the Millenium system including the ability to provide and change access.
- Without a perpetual system for pharmaceuticals, it is impractical to perform test counts to determine if there any overages or shortages.
- Security video is not available to provide evidence if any pharmaceutical shortages do occur or to serve as deterrence to help prevent theft.
- Persons having access to Central Supply inventory assets and controlling the inventory records have an opportunity to convert inventory items to personal use and avoid detection.
- Sharing usernames and passwords limits the ability to determine responsibility for unauthorized or inappropriate activity in the Oracle system.

Cause: Providing security and the appropriate systems to track inventories was not among the highest priorities at the Health Center. Due to the nature of the services provided at the Health Center and the fact that CS is not staffed for the evening and night shifts, providing access to inventory items was felt to be more important than inventory security.

No one requested Oracle access for the employee needing access to perform their job duties at the Warehouse.

Recommendation: The following recommendations can help address the conditions noted above:

- Remove former employees from the Millenium System.
- Further restrict access to Central Supply. If access is needed by employees after Supply Clerks have gone home, limit access to one or two persons with appropriate back-ups.
- Along with the department heads, require the approval of the Director of Support Services or someone else that will understand all of the risk that may arise in granting access to particular areas within the Health Center.
- At least twice a year review all security access within the Health Center.
- Determine if the Mellinium system is capable of providing reports of access changes with automated routing to appropriate personnel (i.e., someone aware of the proposed changes but not having the ability to make changes within the Millenium system) that can verify that appropriate access was granted.
- It is understood that the proposed computerized health care record systems under review will have the capability to assist in inventory tracking. Ensure that adequate segregation of duties is enforced so that those having access to inventory are not able to adjust the inventory records.
- Consider installing security cameras in the Pharmacy.
- Request the appropriate access for warehouse personnel needing Oracle access.

Management Response: The Health Center is in the process of reviewing their security policies and the placement of cameras. Policies will continue to be enhanced as it relates to access to areas. Currently, the Department Head of that area is the only one that can provide the approval

for access. Pharmacy has been identified as an area for an additional camera, and the Health Center will evaluate the Central Supply area for placement. A camera has been utilized on occasion in Central Supply as an investigative measure. The Health Center recognizes the potential for error with their current manual systems. The Electronic Health Record proposals are being evaluated with Central Supply and Pharmacy inventory management as criteria for consideration.

Purchasing recognizes the security issues inherent with having one set of log-in credentials for Oracle at the Warehouse and has requested unique access for the Assistant Warehouse Supervisor.

On-Hand Counts

Criteria: Inventory records should accurately reflect actual physical movement of items, and Management should periodically substantiate and evaluate recorded on-hand quantities.

Condition: Twenty Warehouse and fifteen Central Supply items were tested to determine if the on-hand quantities per inventory records matched physical on-hand counts. Minor discrepancies were noted in the Warehouse. There were discrepancies for 10 of the 15 Central Supply items tested. The value of the Central Supply on-hand counts was approximately \$3,000 less than the \$5,000 recorded value of the inventory tested.

Effect: The Central Supply Inventory is inaccurate. If the sample is representative of the entire inventory, a significant adjustment relative to the Central Supply inventory value may be necessary. Additionally, patients may not have been charged for usage for some of the items resulting in lost revenue. The amounts would not be material.

Cause: Actual Central Supply issuances and other usage (e.g. breakage) were not consistently recorded. The large number of persons with access to Central Supply may have contributed to the discrepancies. Additionally, formal physical counts of inventory were not conducted.

Recommendation: In addition to further restricting Central Supply access, begin recording issuances and receipt in the Central Supply database. Compare issuance to the IMS usage reports for reasonableness. Conduct periodic physical counts of inventory and investigate discrepancies when appropriate.

Management Response: The Health Center is in the process of reviewing their security policies and the placement of cameras. Policies will continue to be enhanced as it relates to access to areas. Currently, the Department Head of that area is the only one that can provide the approval for access. Pharmacy has been identified as an area for an additional camera, and the Health Center will evaluate the Central Supply area for placement. A camera has been utilized on occasion in Central Supply as an investigative measure. The Health Center recognizes the potential for error with their current manual systems. The Electronic Health Record proposals are being evaluated with Central Supply and Pharmacy inventory management as criteria for consideration. The Health Center will review and implement a policy on physical counts. Purchasing will discuss the possible implementation of periodic Cycle counts at the Warehouse with the goal of finding possible Inventory count discrepancies well before the annual physical inventory.

Audit Standards

Internal Audit conducted this audit in accordance with Generally Accepted Government Auditing Standards and the International Standards for the Professional Practice of Internal Auditing. Those standards require that the audit is planned and performed to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. Internal Audit believes that the evidence obtained provides a reasonable basis for its findings and conclusions based on the audit objectives. This report was reviewed with the Purchasing Agent, Eric Carson, and the Health Center Director of Finance, DeDe Will.

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Internal Audit appreciates the excellent cooperation provided by the various departmental directors and staff. If you have any questions or wish to discuss the information presented in this report, please feel free to contact me at (402) 444-4327.

Sincerely,

Mike Dwornicki
Internal Audit Director

cc: Paul Tomoser
Trent Demulling
Joni Davis
Donald Stephens
Thomas Cavanaugh
Kathleen Hall
Patrick Bloomingdale
Diane Carlson
Joe Lorenz
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